FILE COPY

Office - Supreme Court, U.S.
FILED
FEB 25 1948
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term 1947
No. 572

PRUDENCE REALIZATION CORPORATION

Petitioner,

against

GEORGE E. EDDY, *et al.*

BRIEF OF RESPONDENT GEORGE E. EDDY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

SAMUEL SILBIGER,
Counsel for Respondent, George E. Eddy.

SUPREME PRINTING CO., INC., 41 MURRAY STREET, N. Y., BARCLAY 7-0349
49

INDEX

	PAGE
BRIEF OF RESPONDENT GEORGE E. EDDY	1
Opinion Below	1
Jurisdiction	1
Question Presented	2
The Facts	3
The Order Subordinating Bonds Held by Prudence Realization Corporation, and the Settlement Agreement	16
POINT I—The Petition herein does not present any special question of public importance; there is no conflict with decisions of other circuits, the State Courts, nor this Court, so as to merit review	18
CONCLUSION	25

Table of Cases

American Equitable Corporation v. Parkhill, 252 App. Div. 260	23
Case v. Los Angeles Lumber Co., 308 U. S. 106	18, 19
Central Hanover Bank and Trust Company v. President & Directors of the Manhattan Company, 105 F. 2d 130	25
Consolidated Rock Co. v. Du Bois, 312 U. S. 510	18
Ferris v. Prudence Realization Corporation, 292 N. Y. 210, aff'd 323 U. S. 650	20
Florscheim v. Mechanics & Traders Bank, 206 N. Y. 745	5, 18

PAGE

Group of Investors v. Milwaukee Railway Co., 318 U. S. 523 18

Hill v. Wampler, 298 U. S. 460, 466 23

In re Home Title Insurance Company (Mortgage No. 19103), 255 App. Div. 635 20

In re Hopkins Laks Drive Corporation, U. S. D. C. Md., Dec. 6, 1934 (no official citation) 5

In re Matter of Title & Mortgage Guarantee Co., 275 N. Y. 347 20

In re N. Y. Railways Corporation, 82 F. 2d 739 7

Lawyers Title and Guaranty Company, In re Forshay, 279 N. Y. 571 aff'g 254 App. Div. 653, aff'g 169 Misc. 266 20

Matter of Hidden, 243 N. Y. 499 23

Matter of Title & Mortgage Guarantee Co., 275 N. Y. 347 10

Northern Pacific R. R. Co. v. Boyd, 228 U. S. 482 ....5, 7, 18

Pink v. Thomas, 282 N. Y. 10 20

President and Directors of Manhattan Company v. Kelby, cert. den'd 324 U. S. 866 .....10 fn., 17

Re 620 Church Street Building Corp., et al., 299 U. S. 24 7

Tennessee Publishing Co. v. American National Bank, 299 U. S. 18, on November 9, 1936 7

Ticonic National Bank v. Sprague, 303 U. S. 406 20

Vanston Committee v. Green, 329 U. S. 156 18

Statutes Cited

	PAGE
Bankruptcy Act, as amended:	
Section 24(c)	1
Section 77B	4
Judicial Code, as amended:	
Section 240(a)	1

IN THE

Supreme Court of the United States

October Term 1947

No. 572

PRUDENCE REALIZATION CORPORATION,

Petitioner,

against

GEORGE E. EDDY, *et al.*

BRIEF OF RESPONDENT GEORGE E. EDDY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Opinion Below

The opinion of the Circuit Court of Appeals for the Second Circuit is printed in the Record at pages 614-624.

The opinions of the District Court, unreported are printed at R. 22-47, 479; and the unreported opinion of the Special Master is printed at R. 28-72.

Jurisdiction

The petitioner invokes the jurisdiction of this Court under Section 240 (a) of the Judicial Code, as amended, and under Section 24 (c) of the Bankruptcy Act, as amended.

Question Presented

Under the plan of reorganization of the collateral underlying outstanding bonds of the Debtor (after an adjudication that the Debtor was insolvent and it and its general creditors were adjudged to have no interest in such collateral), did the Circuit Court below correctly interpret the plan, in holding that the public holders of the bonds in the several eighteen issues of Prudence Bonds, are entitled to receive payment in full of the principal of their bonds, together with interest thereon at the rate of 5½% per annum, as guaranteed by the Prudence Company, Inc. before said guarantor, or its successor, Prudence Realization Corporation, petitioner herein, as a holder of some of the bonds can participate in the distribution of the proceeds of the respective trust funds?

Statement

The District Court by four orders directed payment to be made of the subordinate bonds of the guarantor's successor, the petitioner herein, although the deficiency in the payment of the accrued interest on the publicly held bonds at the guaranteed rate of 5½% in the Fifth Series amounts as of August 1, 1945, to $411,783.18 (54); such deficiency in interest payments to the public bondholders in the Ninth Series, as of August 1, 1945 amounts to $604,606.17; the like deficiency in the Sixth Series as of July 26, 1946 amounts to $251,405.28 (499); and similar deficiencies in interest payments to the public bondholders exist as to all other series of said bond issues.

The Circuit Court construed and interpreted the plan of reorganization herein and reversed the District Court.

Such reversal was predicated on the special circumstances and facts involved in the particular relationship to the trust funds of the public bondholders and the guarantor of the bonds.

No controversy of public interest or importance with respect to legal principles is involved. The decision of the Circuit Court does not conflict with any decisions of other Circuit Courts, and is in conformity with equitable principles as heretofore established by this Court.

The Facts

Prudence Bonds Corporation, the Debtor was a corporation organized under the Business Corporation Law of New York, with a capital stock of $50,000, all of which was owned by New York Investors, Inc. (241-242). The Prudence Company, Inc. was organized as an investment company under the Banking Law of New York State. All of its common stock outstanding and also 50% of its outstanding preferred stock were owned and held by New York Investors, Inc. Both the Debtor and The Prudence Company, Inc. were subsidiaries of and completely controlled by New York Investors, Inc. (242), and were organized by it to engage in the guaranteed mortgage in vestment business (242-243).

To that end, various bonds and mortgages, cash and other securities owned by The Prudence Company, Inc., were transferred by it to the Debtor, and by the latter, in turn, transferred under trust agreements to various trust companies as trustees to secure the payment of the debtor's bonds, which were delivered by the Debtor to The Prudence Company, Inc. (243). There were eighteen series of such bonds aggregating $56,000,000 (109). Thereupon, The

Prudence Company, Inc. sold the bonds to the general public and guaranteed their payment, both as to principal and interest (109), which was at the rate of 5½% per annum (110). In this way there was sold and transferred to the public all but $1,910,300 of such bonds, which remained in the possession of or were held by the guarantor (31; 111).

This was the situation of the Debtor when on June 29th, 1934 it filed its petition for reorganization under Sec. 77B of the Bankruptcy Act, and trustees were duly appointed, qualified and acted as such. Clifford S. Kelsey is the sole surviving Trustee of the Debtor (29).

The Debtor's first proposed plan related solely to the Fifteenth Series of its bonds, and the object sought to be attained thereby was to scale or cut down its obligations on its bonds by a modification of their terms; extending the maturity of the bonds to May 1, 1945; reducing them to income bonds up to 4½% and cumulative income at 3½% payable on maturity, and reducing the obligations of the guarantor, The Prudence Company, Inc. to a guaranty of the bonds only as modified (194; 206-7). This proposed plan was amended so as to incorporate a provision for the separate reorganization of each of the Eighteen Series of Bonds as a step for the complete reorganization of the Debtor under a General Plan (208).

The respondent Eddy, duly filed objections to said plan based, among others, on the contentions that the plan was unfair and inequitable because the Debtor was insolvent and it "was a device to prefer the stockholders of the Debtor and the New York Investors, Inc., and The Prudence Company, Inc., to the creditors of the Debtor and secure the subordinate rights of such stockholders at the expense of the prior rights of the creditors" and "that the acceptance and

confirmation of such plan would violate the 5th Amendment to the Constitution of the United States" (212).

The said plan and objections were referred to James G. Moore, Esq., as Special Master, for hearing and report. By his report dated March 29th, 1935 (212); he rejected the authorities relied on by respondent, namely, the cases of *Northern Pacific R. R. Co.* v. *Boyd*, 228 U. S. 482; *Florscheim* v. *Mechanics etc. Bank*, 206 N. Y. 745; and *In re Hopkins Laks Drive Corporation*, U. S. D. C. Md. Dec. 6, 1934 (no official citation) and recommended that the objections be overruled (215-216) and the plans be approved as being feasible and equitable (211). The necessary consents of two-thirds of the bondholders had not been obtained, but nevertheless the District Court confirmed the said report in October, 1935, overruled said respondent's objections thereto, approved the plan as filed in good faith and adjudged that it was fair and feasible[1] From this order, no appeal was taken by respondent Eddy.[2]

---

[1] The learned judge below in his opinion, dated October 29, 1935 stated:

> "It seems to me that the plan proposed is a fair and feasible one * * *
>
> Of course, no confirmation of the plan can take place until it has been accepted by the required number of consents, but I see nothing in the objections that this Court must refrain from expressing its opinion of the proposed plan until such consents have been filed and the matter is before the Court for final confirmation. * * *"

[2] Counsel advised Mr. Eddy that the order was only tentative and could not be made final until the plan was consented to by the requisite number of bondholders and as the proposed plan had not been accepted and confirmed he in no way suffered injury and the decree was therefore not appealable. It was not until September 1938 that the scope of the Appellate jurisdiction of the Circuit Court was clearly broadened by the Chandler Act to cover appeals from all interlocutory orders in reorganization proceedings.

Thereafter similar separate plans of reorganization of the other seventeen series were proposed by the Debtor, the only substantial change being in the modification of the bonds to income bonds up to interest at the rate of 5½% and the omission of any provision for cumulative interest at a fixed rate (164; 219).

The Debtor, failing to secure the desired consents to such plans, and meeting with strenuous opposition to the provision relating to the guaranty of The Prudence Company, Inc., again amended its proposed plans by eliminating the provision reducing The Prudence Company, Inc., guaranty to a guaranty only of the payment of the bonds as modified, and substituting therefor a provision preserving the rights of the bondholders on the said guarantees to the extent permitted by law (178-179; 221).

Subsequently and about August, 1936, the clause relating to said guaranty was further amended by an additional paragraph being added thereto and providing that—if, as a matter of law, the bonds owned by The Prudence Company, Inc. are subordinate to the Publicly Held Bonds, such bonds so held by the guarantor shall not be entitled to receive any distribution of the proceeds of the Trust Funds "Until all of the Publicly Held Bonds have been fully paid, redeemed, purchased or retired" (179).

All these plans proposed by the Debtor contained similar provisions for the modification of its bonds and converting them to bonds bearing interest at 5½% if earned (164); all contained a clause providing for their integration into a general plan for the complete reorganization of the Debtor (222; 208).

About February 11, 1936, the Debtor proposed a general plan of reorganization which was referred to James G. Moore, Esq., for hearing and report (225, 227).

In the interim, from the time of the approval by the Special Master and the District Court of the plan for the Fifteenth Series in October, 1935, and pending the consideration of the general plan and the other Seventeen Series separate plans, the Circuit Court in March, 1936, rendered its decision in *re N. Y. Railways Corporation,* 82 F. 2d. 739, re-affirming the doctrine of *Northern Pacific R. R. Co.* v. *Boyd,* 228 U. S. 482. Certiorari was denied June 1st, 1936, 298 U. S. 687; and this Court rendered its decision in *Re 620 Church Street Building Corp., et al.,* 299 U. S. 24 and *Tennessee Publishing Co.* v. *American National Bank,* 299 U. S. 18, on November 9th, 1936.

Thereupon and on March 11, 1937, the Special Master rendered an intermediate report on the Debtor's general plan wherein he found "that the Debtor is insolvent; that the fair market value of all of the assets pledged to secure all of the series of First Mortgage Collateral Bonds of the Debtor is insufficient, in each series, to pay the Debtor's obligations for principal and interest upon said First Mortgage Collateral Bonds; that the Debtor has no equity in the pledged collateral; that the general creditors have no equity in the pledged collateral; * * *" (259) and concluded

> "It necessarily follows, as conclusions of law, that the Debtor's Plan is unfair and inequitable; that it discriminates unfairly in favor of general creditors and stockholders as against the bondholders and that it cannot be approved in its present form" (260).

Up to the time this intermediate report of the Special Master was made, the bondholders consisting of the general public and The Prudence Company, Inc., were classified as

one group of creditors of the Debtor (212), and the Special Master apparently assumed that The Prudence Company, Inc., as guarantor of the bonds, and the public bondholders had a co-ordinate and equal interest in the collateral trust funds (218).

The said intermediate report stated that the proceeding for the reorganization of the Eighteen Series of the Debtor's bonds were being conducted on the theory that for reasons of efficiency and economy it was advantageous to the bondholders that they unite in a reorganization by which their several interests would be under the management of one corporation whereby they "should not only preserve for themselves the full value of their own collateral, but by union, they should enable the less fortunate to be benefitted from any excess of collateral of the better issues (261-262).

To attain these objects the Special Master proposed the amended general plan for the reorganization of the Debtor, entirely eliminating the Debtor, its stockholders and general creditors from the picture; and providing that a new corporation be formed to be owned and controlled by the bond holders (262-263).

On April 27, 1937, the District Court approved and confirmed the Special Master's report and adjudged that the Debtor was insolvent and that the fair value of the collateral securing each of the Eighteen Series of Bonds was less than the principal amount of the outstanding bonds and accrued interest thereon, and that the Debtor, its stockholders and general creditors had no equity in such collateral (275).

The said report of the Special Master dated March 11, 1937, analyzed the value of the collateral underlying the

Eighteen Series of Bonds and disclosed that in each series the collateral was less than the outstanding publicly held bonds. In the Sixteenth Series the deficit of the collateral to meet the outstanding bonds was $904,394.74 (256, 257), the amount of the bonds held by The Prudence Company, Inc., was but $2,200 (32) making the deficit to meet the publicly held bonds and interest over $902,000. In the Tenth Series he found the deficit to be $360,000 (257). The Prudence Company, Inc., held $19,000 (32) of Tenth Series Bonds, leaving the Trust Fund deficit of over $340,000 to meet the publicly held bonds.

But no recommendation was then made, nor was any order then entered, to eliminate The Prudence Company, Inc., from participation in the proceeds of the collateral underlying the Eighteen issues of the Debtor's bonds.

However, by an order made July 21, 1937, based in part on a supplemental report of the Special Master dated April 27, 1937, it was adjudged and decreed that the bonds that had been held by the guarantor (which was itself in reorganization), and then held by its Trustees, were subordinate to the bonds of the general public; that they were not entitled to share in the collateral securing the Eighteen Series of bonds and are not enforceable obligations either as to principal or interest against their respective trust funds, or the proceeds thereof * * * until all other Prudence Bonds in the hands of the general public have been provided for in full, both as to principal and interest heretofore accrued or hereafter accruing * * * but if and when and only after all other Prudence-Bonds in the hands of the general public in a particular series have been paid or provided for in full, both as to principal and interest, as

aforesaid, then, and in that event only, said Prudence-Bonds held by the said Trustees of The Prudence Company, Inc., in that particular series are entitled to share in the said collateral and proceeds thereof as aforesaid; * * * (112-113).

From the said decree determining and fixing the relationship to the trust funds of the public bondholders and the guarantor as a holder of some of the bonds, the guarantor's trustees in reorganization appealed to the Circuit Court. The Court of Appeals of New York on July 13, 1937, had handed down its decision in the *Matter of Title & Mortgage Guarantee Co.*, 275 N. Y. 347, indicating that a guarantor as part owner of the obligations guaranteed by it was not entitled to share in funds securing such obligations on a parity with the public owners of such obligations so guaranteed by it.

Thereupon, a compromise and settlement was effected between the Trustees of The Prudence Company, Inc., and the Trustees of the Debtor herein for the withdrawal of said appeal upon the payment to the former of $150,000 out of the trust funds as a reorganization expense (R. 147 F. 2d 465; 483, 487).* This settlement was approved by an order of the District Court entered January 7, 1938 (113).

Upon the determination by the Court that the Debtor was insolvent and the entry of the order eliminating the Debtor, its stockholders and unsecured creditors from any share or interest in the Eighteen Series Trust Funds, the plans theretofore proposed by the Debtor and which had for their object the "scaling down" of its obligations and

---

* Refers to Record in *President and Directors of Manhattan Company* v. *Kelby*, cert. den'd 324 U. S. 866.

the creation thereby for the Debtor of a previously non-existent equity in the various trust funds at the expense of the bondholders were necessarily unfair, inequitable and not feasible and ran counter to the Court's decision and order. It became necessary therefore to convert the proposed Debtor's plans to plans for the reorganization solely of the bondholders' rights in the collateral securing the respective series of bonds.

At that time, the bondholders relied on the order of July 27, 1937, and rightly believed that as all of the Eighteen Trust Funds were insolvent the only parties entitled to share in any distribution of the proceeds of the trust funds were the public bondholders to the extent that such funds realized sufficient to pay the public bondholders the principal of their bonds, together with the interest thereon at the rate of 5½% per annum, and only after the payment of the publicly held bonds in full with interest accrued and to accrue at such rate of 5½% could there be an excess or surplus available for the discharge of the subordinate bonds of The Prudence Company, Inc., guarantor, or its successors in interest.

With the avowed purpose of preserving these rights of the public bondholders, and with the intent of preserving for them the "full value of their own collateral" (262) the proposed plans of the Debtor were modified under the supervision of the representative of the Court, i.e. the Special Master, and it was assumed that by changing the definitions so as to eliminate the Debtor from the picture and by adding provisions integrating each plan with the General Plan proposed by the Special Master in his report of March 11, 1937 the object sought was fully attained (272;

181). It was not suggested to the public bondholders that acceptance of the plans so amended would vitiate the order of July 21, 1937, or would diminish their priority rights over the subordinate bonds of The Prudence Company, Inc. and its successors; or that such subordinate bonds would be able to participate in the Trust Funds before the priority bonds were paid in full with interest at 5½%; or that the effect of the plan would be to transfer to the subordinate bondholders the equity in any potential difference between the earned income and fixed interest at the rate of 5½%; nor was any consideration paid by the subordinate bondholder to support and validate any such claimed transfer.

About January 18th, 1938 the amended general plan and the separate plans for each series except the Fifteenth Series were approved and confirmed (114). The new corporation owned by the bondholders as the sole stockholders was organized pursuant to the plan (115); March 1st, 1938 was fixed as the effective date of the Plan of Reorganization, and Supplemental Trust Agreements were entered into between the New Corporation and City Bank Farmers Trust Company as Trustee of all eighteen trust funds (117). No new capital was invested in the New Company but it received funds to pay reorganization expenses and for operating capital by contributions from the eighteen trust funds (Ex. A, 574).

The Supplemental Trust Agreements recited that the bonds shall bear interest * * * at the rate of 5½% per annum "if and only to the extent that the annual collections of net income * * * received from the collateral shall suffice to pay such interest." The maturity date of the bonds was extended to May 1, 1945, and it was provided that

"Any * * * deficiency or deficiencies of interest remaining on May 1, 1945, or if the maturity of the Bonds be extended remaining on May 1, 1950, will not become due and will not be paid by the Corporation and any right to such deficiency or deficiencies will after the final maturity date be void and of no effect" (121). The several plans contained no provisions voiding the bondholders rights to such deficiencies. On the contrary, the plans provided that the old trust indenture should be modified to conform to the plan and that the Modified Trust Indenture shall include such additional or substitute provisions, not inconsistent with the plan as may be necessary to carry out the Plan (176-177), and the order approving the form of Supplemental Trust Agreement proceeds on the assumption that the agreement was in compliance with the respective separate plans of reorganization theretofore confirmed and did not materially change or modify any provisions of the plans (664). By each Supplemental Trust Agreement it was also specifically provided that the purpose of the Supplemental Trust Agreement was to set forth the amendments and modifications required in the original trust agreements by the plan of reorganization (318) and also that the agreement of guaranty of The Prudence Company, Inc., * * * the texts of the Bonds * * * and the guaranty of the Prudence Company, Inc. * * * shall remain as set forth in the Original Trust Agreement (321). The several Supplemental Trust Agreements were not submitted to the bondholders for their approval and consents thereto, but were approved by the Court as not materially or adversely affecting the rights of those who theretofore accepted the plans of reorganization (R. 147 F. 2d 465; 1512-1513; 324 U. S. 866).

By orders dated April 27, 1938 and June 6th, 1938 the indenture trustees were directed to transfer the respective trust funds to City Bank Farmers Trust Company; and were authorized to file their respective accounts of their acts and proceedings as trustees and apply for a judicial settlement thereof (116-117).

As a result of such accountings the accountant trustee in the Fifth Series was surcharged with and paid into the Trust Fund on May 16th, 1945 the sum of $1,572,991.03 (437); and on the same date paid a surcharge in the Ninth Series in the sum of $221,533.04 (439). In all other series, except Series A, 10th and 15th, which are still pending, the indenture trustees paid various sums in settlement of the objections to their accounts, with the approval of the District Court.

The payments of the surcharges in the Fifth and Ninth Series, brought about a new situation which was not within the contemplation of the public bondholders at the time the plans were accepted and confirmed, and at the time the supplement trust agreements were entered into between the New Corporation and the successor trustee.

It transpires that after the distribution to the public bondholders of the earned income in the Fifth Series—said income being insufficient to pay interest at the rate of 5½%—there will remain in principal account a sum adequate to pay the principal amount of the publicly held bonds and leave a substantial surplus. The same situation is presented in the Sixth and Ninth Series, and may arise in some of the other series.

By a report of the Special Master, dated March 11th, 1938, the amount of outstanding bonds in the respective

series was fixed; also, the date to which interest thereon had been paid at the rate of 5½% as of the effective date of the plans; also, the sums to be paid out of the corpus of the respective trust funds to the New Corporation for operating and reorganization expenses, and to be advanced or loaned from income account where cash was not available in principal amount to pay same (Ex. A; 574).

In the present controversy, the Special Master in respect to the Fifth and Ninth Series recommended that after payment of the principal of the outstanding publicly held bonds, the trust *res* should be applied to the payment of the principal of the guarantor's subordinate bonds; [in the Fifth Series $67,200 (55) and in the Ninth Series $105,700 (547, 583)] to a repayment by way of recoupment to the surcharged accounting trustee [in the Fifth Series $85,825 (57) and in the Ninth Series $88,124.98 (547, 583)], and that any excess then remaining should be distributed to other series of Prudence Bonds.

The District Court adopted said recommendation, although there was an unpaid deficiency of interest due the public bonds in the Fifth Series of $411,783.18 (54) and in the Ninth Series of $604,606.17 (541, 586). In the Sixth Series the deficiency of interest due the public bondholders is $251,405.28 (499). By the order relating to all series, the District Court instructed the Trustee to make like distributions, notwithstanding that in each series there is a similar unpaid deficiency of interest due the public bondholders, and in each series the trust fund is inadequate to discharge the principal and interest at the guaranteed rate of 5½%. By disregarding the unpaid interest due to public bond-

holders, the decrees award to the guarantor's subordinate bonds the right to share in the distribution of the respective trust *res*.

The Circuit Court of Appeals unanimously reversed the District Court and held that the public bondholders are entitled to be paid the said deficiencies in interest before the subordinate bondholders can participate or share in such distribution (614-618).

The Order Subordinating Bonds Held by Prudence Realization Corporation, and the Settlement Agreement

The Prudence Company, Inc., predecessor of the petitioner, filed its claims herein as holder of $1,910,300 face amount of the Debtor's bonds, with interest thereon (32). It also filed claims as a general creditor in the aggregate amount of approximately $9,000,000 (250).

By the order of April 27th, 1937, the Debtor was adjudged insolvent and that the Debtor, its stockholders and general creditors have no equity in the pledged collateral in any of the Eighteen Series of the Debtor's bonds (275, 110). From this order no appeal was taken.

By a decree made July 21st, 1937, it was adjudged that the bonds in the aggregate sum of $1,910,300 now held by Prudence Realization Corporation, the petitioner herein, were subordinate to the publicly held bonds, and were not entitled to any share of the proceeds of the respective trust funds until the publicly held bonds were "paid or provided for in full, both as to principal and interest heretofore accrued or hereafter accruing * * *" (112-113).

From said decree the petitioner herein appealed to the Circuit Court below, and before decision, a compromise and settlement was made and the appeal withdrawn, with the approval of the District Court (113-114).

The petition and settlement agreement respecting said appeal are contained in the Record on Appeal in the proceeding entitled, *President, etc. of the Manhattan Company* v. *Kelby,* pages 467-496; before this Court on a petition for a writ of certiorari, which petition was denied in 324 U. S. 865 ~~865~~ 866.

The agreement of subordination of the guarantor's bonds subordinated such bonds to the rights of the bondholders as defined in paragraph 11 of the several plans of reorganization and the order of July 21, 1937 (R. 324 U. S. 465, 5th Series, p. 488, fol. 1446) and provided:

> "Nothing herein contained or the execution or consummation of this agreement is in any way, to affect, vary, impair or increase the rights of the bondholders of the Eighteen Series of Prudence-Bonds with respect to the guarantee thereof made by The Prudence Company, Inc." (R. 324 U. S. 465, 5th Series p. 488, fol. 1463.)

POINT I

The Petition herein does not present any special question of public importance; there is no conflict with decisions of other circuits, the State Courts, nor this Court, so as to merit review.

(a)

The decision below determined the priority rights of secured creditors under the terms of the plans of reorganization. It construed what it considered equivocal language, in the light of the surrounding factual circumstances, and in so doing, it follows the principles of equity as enunciated by this Court in,

Vanston Committee v. *Green*, 329 U. S. 156;
Consolidated Rock Co. v. *Du Bois*, 312 U. S. 510;
Group of Investors v. *Milwaukee Railway Co.*, 318 U. S. 523;
Case v. *Los Angeles Lumber Co.*, 308 U. S. 106;
Northern Pacific Railroad Co. v. *Boyd*, 228 U. S. 482;

and by the New York Court of Appeals in,

Florscheim v. *Mechanics & Traders Bank*, 206 N. Y. 745, reversing 137 App. Div. 149 on dissenting opinion of Clark, J.

The petitioner concedes that ordinarily senior creditors must be paid in full before junior creditors may take anything; but urges that the rule does not apply in the instant case—because it claims the right of seniority of the

public bondholders was disputed—and such senior rights were partially surrendered under a compromise based upon valuable consideration. But this contention is belied by the undisputed facts.

In the compromise of petitioner's claim, there was no surrender by the public bondholders of their full legal priorities—on the contrary, they were fully preserved. By the withdrawal of its appeal, the petitioner herein accepted the order of July 21st, 1937, as the final adjudication of its status as a subordinate bondholder, and that the public bondholders were entitled to receive payment of their bonds in full together with interest accrued and thereafter accruing, before it could share in the proceeds of the trust funds.

Again, to support the alleged surrender by the public bondholders of their priority rights, petitioner suggests that it waived approximately $9,000,000 worth of claims—but in truth and fact the claims were worthless. They were general claims against the Debtor corporation. The Corporation had been adjudged insolvent and its general creditors and stockholders were eliminated by the prior order of April 27th, 1937, from which no appeal was taken. The petitioner paid no consideration for any surrender by the public bondholders of their priority rights, but on the contrary the bondholders paid $150,000 for a claim that had no greater dignity than a "sheer nuisance value." *Case* v. *Los Angeles Lumber Co., supra.*

The compromise agreement did not subordinate the petitioner's bonds to the publicly held bonds "as modified by the plans" but to the rights of the bondholders as subordination is defined in paragraph 11 (R. 178) of the sev-

eral plans (R. 324 U. S. 866; p. 482) and as such rights were adjudicated by the order of July 21st, 1937. Indeed, the specific provision of the compromise agreement was that thereby the rights of the bondholders should *not be varied or impaired* with respect to the guarantee of The Prudence Co., Inc. (R. 324 U. S. 866, p. 488, fol. 1463).

The sole question then that the Circuit Court adjudicated was what those rights of the public bondholders were --and its decision is in full accord with the decisions of this Court and the Courts of New York State.

Ticonic National Bank v. *Sprague,* 303 U. S. 406;
Ferris v. *Prudence Realization Corporation,* 292 N. Y. 210, aff'd 323 U. S. 650;
In the Matter of Title & Mortgage Guarantee Co., 275 N. Y. 347;
Lawyers Title and Guaranty Company, In Re Forshay, 279 N. Y. 571 aff'g 254 App. Div. 653, aff'g 169 Misc. 266;
Pink v. *Thomas,* 282 N. Y. 10;
In Re Home Title Insurance Company (*Mortgage No.* 19103), 255 App. Div. 635.

(b)

The petitioner, failing to point out any provision of the plan of reorganization or the compromise agreement to support its erroneous claims that such documents effected a modification of the rights of the public bondholders so as to reduce the obligation of the guarantor to a guarantee of payment only of the earned income, advanced the specious contention that, in any event, such reduction of the rights of the bondholders and the liability of the guarantor

were accomplished by reason of the provisions of the supplemental trust agreement; that the District Judge had rendered a decision that the supplemental trust agreement did not materially affect the rights of the bondholders—and as no appeal was taken, such decision is final, even if erroneous, and therefore the decision of the Circuit Court below is in disregard of settled principles of *res judicata* and in conflict with decisions of this Court and other Circuit Courts of Appeals; citing various cases which are inapposite and have no relation to the facts in this case.

The order approving the supplemental agreement was made after the order of confirmation of the plan of reorganization. The latter order stemmed from the power conferred and the duty imposed on the District Court by the provisions of the Bankruptcy Act, Sec. 77B. f. Such an order was an adjudication that determined conflicting rights, having all the incidents of a judgment or decree, after a due trial. Of course, such order, in the absence of an appeal, is final and *res adjudicata* as to all matters comprised within the litigation. The precedents relied on by petitioner pertain to such a final decree, and are inapposite to an incidental order, subsequent to the litigation, and which has its origin or basis, not in any provision of the statute, but in the terms of the plan.

It was by virtue of a provision of the plan that the District Court made the order approving the supplemental trust agreement. The plan provided that "The present Trust Indenture shall be modified *so as to conform with the Plan,*" and shall contain such additional or substitute provisions *"not inconsistent with the Plan* as may be necessary or advisable *to carry out the Plan"* (175) and "shall be subject to the approval of the Court" (176).

The supplemental trust agreement was not intended to be the medium of effecting any material alteration or modification of the rights of of the public bondholders, or to change or in any way amend the Plan. It was not proposed and offered for the approval of the Court as "amending" the plan, and the order approving the form of the agreement was not the result of an adjudication by the Court of contested rights of adversary litigants. The Court approved the "form of Supplemental Trust Agreement" recommended by the Special Master (660, 661) and was so thoroughly unapprised that such form of Supplemental Trust Agreement proposed any material modification of the plan that in the provision of the order directing the execution of the Supplemental Trust Agreements as to each of the Eighteen Series of bonds, he directed that each Supplemental Trust Agreement "may * * * be submitted to this Court without notice for ex-parte approval" (665).

The approval of the form of Supplemental Trust Agreement by the Court cannot be accorded any greater degree of finality than if the plan had provided that the supplemental trust agreement should be approved by counsel. If counsel approved the agreement, there would still be open for adjudication by the Court the question whether the parties entering into such agreement exceeded the powers and authority conferred upon them by the Plan, and a final adjudication within the rule of *res adjudicata* would be applicable only after by adversary proceedings the issue of the rights of the parties under the agreement were presented to the Court for determination. The rule has no application to a summary order, where the issue was not directly presented to and passed on by the Court.

Hill v. *Wampler*, 298 U. S. 460, 466;
Matter of Hidden, 243 N. Y. 499;
American Equitable Corporation v. *Parkhill*, 252 App. Div. 260.

In the instant case the Special Master reported on those provisions of the Supplemental Trust Agreement which in any way deviated from or changed the plan, and recommended that such modifications were not material or adverse to the interests of the bondholders (675; 677). Those particular modifications of the plan directed to its attenion the Court passed on and approved.

As to the rest of the agreement, which "descends to particulars not found in the plan" the Special Master did not direct the attention of the Court thereto; he did not direct the attention of the Court to Sections 8 and 10 of Article II of the Supplementary Trust Agreement or suggest that thereby the plan was being modified or amended; but reported that such particulars "are in accordance with the spirit and purpose of the plans and are in no sense modifications of or amendments to said plans" (676).

Obviously, therefore, the question of whether Sections 8 (336) and 10 (340) of Article II of the Supplemental Trust Agreements conflicted with Section 11 of the plans (178) and the order of July 21, 1937 (112) and the terms of the compromise agreement (R. 324 U. S. 866, pp. 482-488) was not presented to the Court for determination and was not passed on by it; and the principle of *res judicata* is inapplicable to the facts in this case.

It is clear from a reading of the plan of reorganization, that the dominant purpose of the plan was to preserve all

the legal rights of the public bondholders; to create a servicing agency to liquidate the collateral underlying the respective eighteen bond issues in the interests of the public bondholders, and that their priority rights in such collateral should remain unimpaired, "irrespective of the provisions of this Plan" (178-179).

The contention that ownership of the stock of the New Corporation and the right to share in the income of the New Corporation and in any excess collateral of other series constituted compensation to the public bondholders equivalent to a surrender of their priority rights in the respective eighteen trust *res* is unrealistic and ignores the fact that we are dealing with an insolvent estate; that the liquidating agent, i.e., the New Corporation, had no assets except as taken from the trust funds constituting the collateral underlying the publicly held bonds; and had no source of income except as derived from the servicing and liquidation of such collateral; and as a liquidating agent it could in no way be responsible except to perform its duty to apply the income received and the proceeds of the collateral to the *pro rata* payment of the publicly held bonds. Of course, the New Corporation could not be obligated to pay more income than was received, and its *pro forma* agreement to pay the principal of the bonds at the extended due date was an unenforceable promise except only insofar as such collateral realized sufficient to pay the same. A realistic view of the relationship of the public bondholders and the New Corporation is that they were principal and agent and not creditor and debtor. If it be assumed that the New Corporation was a debtor, and not merely a liquidating agency, then the New Corporation was totally in-

solvent from its birth, as it possessed no assets save only the right to service the collateral. (*Central Hanover Bank and Trust Company* v. *President & Directors of the Manhattan Company,* 105 F. 2d 130.)

CONCLUSION

The petition for a Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit should be denied.

SAMUEL SILBIGER,
Counsel for Respondent, George E. Eddy.